

**Alabama Trust Fund
Board of Trustees Meeting
June 5, 2012
State Capitol, N-202**

MINUTES

Present:

Governor Robert Bentley, Chair
Dr. Marquita Davis, Vice Chair
Mr. Young Boozer, Secretary
Mr. Terry Bunn
Mr. Daniel Hughes
Dr. Sandra Sims-deGraffenried

Absent:

Mr. Rich Bielen
Mr. Raymond Harbert
Mr. Bill Slaughter

Agenda Item 1.

Pursuant to public notice, a meeting of the Alabama Trust Fund Board of Trustees was held on June 5, 2012. The meeting was called to order at 9:00 AM by Chairman Gov. Bentley.

Agenda Item 2.

The roll was called by Secretary Boozer and recorded as follows with a quorum present.

Agenda Item 3.

The first order of business was review and approval of the minutes. Upon motion made by Dr. Sims-deGraffenried, and a second by Mr. Boozer, the reading of the minutes was dispensed and the minutes were unanimously approved as presented.

Agenda Item 4.

Gov. Bentley asked Mr. Boozer to provide background on SB 147 that affects the Alabama Trust Fund. Mr. Boozer stated that SB147 simplifies the annual disbursement structure by defining a spending policy. He reviewed the proposed structure. An amendment was attached to SB147 that transfers approximately \$438 million from the ATF to the General Fund over a three year period. HB13 was passed in the special session that is expected to bring additional monies to the General Fund through use tax and taxes assessed against internet purchases. Gov. Bentley stated 2013 will be a difficult year for the General Fund due to little to no growth in the taxes funding the General Fund. Previous budgets have been sufficient due to one-time monies. He stated that HB13 is a beginning tool to get some growth taxes to the General Fund, but he noted it is not enough. He noted that he does not favor raiding the Alabama Trust Fund, but that the situation is dire.

The next order of business was to review the quarterly financial reports. Mr. Boozer summarized the financials, and noted that income and royalties had decreased over this period last year. He recognized a new graph provided by the Oil & Gas Board that provides a good visual of royalty production, sales and price. Other reports were reviewed and received as information.

Gov. Bentley departed the meeting, and Ms. Davis assumed the chair. A quorum was still present.

Vice Chair Davis asked Ms. Annoesjka West, Callan and Associates, to provide a market update, to present the quarterly performance report, to review the April flash report, and to review the manager watch list. Ms. West provided a general market recap noting that the market environment continues to be volatile, and that the concerns around the European debt

crisis started another flight to quality, sending equity markets back into negative territory and wiping out much of the unrealized gains year-to-date. The quarter ending March was positive with an actual return of 5.08% for the total fund vs. the target of 4.14%. The one year horizon portrays the withdrawals from the fund that occurred at an inconvenient time resulting in a 6.73% return vs. the target of 7.13%. The total asset class performance for five years and one year are strong. In reviewing the equity managers, Ms. West noted RSA slightly lagged the benchmark. While Atlanta Capital lagged the benchmark for the quarter, the longer term return was good. Batterymarch had an 8.83% net return; however, it was below the benchmark. GMO and Wells are new managers and do not yet have enough data for long-term performance comparison. All domestic fixed income managers beat the benchmark, especially those managers with a core plus focus.

Ms. West reviewed the April flash report. Mr. Hughes noted Angelo Gordon has a negative return for the quarter and a poor performance in April, and inquired if there is reason for concern. Ms. West stated the investment in real estate is incremental and we should see meaningful performance over a longer period, after AG starts deploying the capital. Ms. West recommended that Smith and Turner each remain on the watch list for another year with the goal to get a three year return above their respective benchmarks. Upon motion made by Dr. Sims-deGraffenried, and a second by Mr. Hughes, the motion to keep Smith and Turner on the watch list for one year carried unanimously.

Ms. West presented securities lending information that was requested at the last meeting. She reviewed the securities lending holdings report for BNYM noting no issues. Year-to-date earnings on the portfolio are \$144,454. The NAV:1.0002 remains above 1.0 with no significant losses since inception. RSA provided a written update to the information presented to the board last year. Ms. West reminded that board that the collateral portfolio is segregated into two pools – liquidity (92.2%) and duration (7.8%). The collateral pool has experienced no defaults. The duration pool is still priced below a \$1 NAV. The shortfall is less than last year's estimate of \$200,000 due to the general improvement in the credit markets. Mr. Hughes requested a security holdings report to be included in the next board package.

Agenda Item 5.

Vice Chair Davis called on Mr. Jay Kloepper, Callan & Associates, to review the asset allocation and spending study. Mr. Kloepper summarized that the purpose of the report is to provide the basis for selecting an asset allocation policy that appropriately reflects risk and return objectives given the spending policy. He stated that spending 75% of gains is deteriorating the corpus. He reviewed changes since the 2008 study, noting substantially lower projections for gas royalty revenues as provided by the Oil and Gas Board. Mr. Kloepper provided an overview of the model and the capital market outlook.

Efficient asset mix alternatives, expected return, and expected standard deviation were presented. The existing asset classes and allocation were compared to additional mixes with the same asset classes. Mr. Kloepper mentioned other alternative asset classes used by other institutional investors, and noted the difficulties of diversifying the ATF portfolio due to the current spending policy. The difficulties include the challenge to track income and capital appreciation and liquidity needs. Alternative asset classes should be revisited if the spending policy is changed through the discipline of the board, or with the proposed constitutional amendment.

Mr. Kloepper stated that the general rule of thumb was not to spend more than the return minus inflation. The current policy allows spending substantially more than 5% or the expected real return. He noted that a 5% spend is targeted by a majority of foundations and endowments, and also noted that generating a real return of 5% is a challenge in the current markets. The current royalty stream can allow some spending beyond the expected real investment return;

however, as the royalties decline, the corpus will be eroded. On page 39, Callan portrayed the extreme volatility of spending under the current spending policy versus the more predictable spending policy in the proposed constitutional amendment. Should the proposed spending policy be adopted, the Board should consider more aggressive asset mixes with greater equity exposure.

In summary, Mr. Kloefer mentioned the objectives of maintaining or increasing real spending while maintaining or growing the real value of the trust fund. He stated that the royalties are insufficient to offset the spending generated by the current 75% capital gains spending level, and that the real value of the corpus will decline. It is not advisable to change the asset allocation to be more aggressive in the current spending mode because it too will diminish the corpus. He urged the board to consider other plans if the proposed constitutional amendment passes.

Agenda Item 6.

At this time, there is no decision to be made.

Mr. Boozer referred the board to page 29 and commented that while the proposed spending policy has a maximum 5% spending, it is actually closer to 4.5% due to averaging the past three fiscal years.

Vice Chair Davis thanked Mr. Kloefer for his thorough report. Mr. Kloefer will provide a summary of the report as an outstanding item for the August meeting.

Agenda Item 8.

There being no further business, the meeting was adjourned at 11:05 AM.

Dr. Marquita Davis, Vice Chair

Young Boozer, Secretary